# U.S. Competitors Respond Dramatically to High World Wheat Prices

*by*
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**Abstract**: During 1996/97 all of the United States' major export competitors increased acreage in response to the sharp increase in world wheat prices that began in the 1995/96 crop year. Increased wheat plantings and generally favorable growing conditions in these countries mostly contributed to the second largest world wheat output on record and provided greater competition for U.S. wheat exports in a smaller global market. The USDA baseline projections to 2000 indicate lower wheat prices in the coming years relative to 1995/96 and 1996/97, which should cause competitors to shift some area to alternative crops. However, the projected wheat area for these countries as a group is expected to stay relatively stable because wheat prices are expected to remain attractive compared to the late 1980s and early 1990s. The projected wheat prices are based on the USDA baseline assumptions that strong global demand growth, particularly in East Asia, will continue and the GATT Uruguay Round Agreement disciplines on agricultural trade will be fully implemented.

**Keywords:** Wheat prices, baseline, Argentina, Australia, Canada, European Union, Uruguay Round Agreement

### *Introduction*

A key question in the spring and summer of 1996 was how the major world wheat producers would respond to the record high prices and tight exporter stocks. Furthermore, with world consumption exceeding production in each of the previous 3 crop years, the global stocks-to-use ratio for 1995/96 was the lowest on record, according to the USDA database.

This article details how the United States' major competitors (Argentina, Australia, Canada, and the European Union) responded to high international wheat prices for the 1996/97 crop year and projects wheat production and exports for these major competitors to the year 2000. The projections were prepared for the annual USDA projections of long-term agricultural supply, demand, and trade for agricultural commodities. [2] Known informally as the "baseline," the projections combine model results and judgmental analysis in arriving at the outcomes. The baseline is not a forecast, but rather a conditional, long-run scenario about what would be expected to happen under a specific set of assumptions.

The USDA baseline makes many assumptions about the United States and other countries. Changes in any of the assumptions can significantly alter the projections, and actual conditions that emerge will alter the outcomes. Therefore, the baseline provides a point of departure for analysis of alternative agricultural trade and policy scenarios. Some of the more important assumptions of the current USDA baseline include:

- Normal weather, meaning there are no year-to-year supply shocks due to abnormal weather;
- Robust population and income growth in developing countries, especially East Asia;
- Further enhancement of incomes by the full cumulative impact of trade liberalization under the Uruguay Round Agreement of the General Agreement on Tariffs and Trade (GATT);
- Full compliance with all bilateral and multilateral agreements affecting agriculture and agricultural trade; and
- No accession to the World Trade Organization (WTO) by China, Taiwan, and the Newly Independent States (the former Soviet Union); no enlargement of the European Union beyond its current 15 member countries; and no expansion of the North American Free Trade Agreement (NAFTA).

As a group, the four major U.S. competitors reacted to high wheat prices by raising 1996/97 output 23 percent from the preceding year. Their 1996/97 (July/June) exports are expected to be up 24 percent. Although world wheat trade is forecast down in 1996/97, the major U.S. competitors increased their exports, in the aggregate, because of sharply larger supplies and tight U.S. wheat supplies. Under the USDA baseline, aggregate wheat exports by the four major competitors in 2000/01 are projected to be 58.8 million tons, accounting for 55 percent of projected world wheat trade. U.S. wheat exports are projected to be 36.7 million tons in 2000/01, comprising 34.5 percent of world wheat trade. However, wheat export potential in Argentina, Australia, and Canada is expected to be limited by land constraints and attractive prices for competing crops. Additionally, the Uruguay Round Agreement export subsidy limits are gradually reducing allowable European Union (EU) subsidized exports in coming years.

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[2] *Agricultural Baseline Projections to 2005, Reflecting the 1996 Farm Act.* Interagency Agricultural Projections Committee, World Agricultural Outlook Board, U.S. Department of Agriculture, Staff Report WAOB-97-1, February, 1997.

World prices are expected to remain below levels that would permit the EU to export without subsidies.

### *Argentina's Production and Exports Forecast At Record Highs*

Argentina's wheat production for 1996/97 is forecast at a record 15.5 million tons, based on a strong area response to high world prices, fairly good weather, and increased use of fertilizers and pesticides that produced close to record yields. Farmers planted almost 7 million hectares, up 40 percent from the previous year and the highest since 1982/83. Weather in many areas was normal to good, partly accounting for the record crop. Farmers, encouraged by favorable prices, increased fertilizer use to an estimated 70 percent of wheat area, compared with slightly over 50 percent last year. With the increase in planted area, the actual area fertilized doubled in a year. Producers also increasingly adopted other cultural practices, such as systemic fungicides and herbicides, as well as minimum and no-till practices to conserve soil moisture.

Exports for the local 1996/97 December/November marketing year are forecast at a record 11 million tons. Argentine exporters and the government, at times, have been aggressively marketing wheat in international markets. Although Brazil is again expected to take the largest volume of exports, other markets, notably North Africa, Eastern Europe, and East Asia, have been purchasing Argentine wheat this marketing year. Brazil, as a member of the Mercosur customs union formed by Argentina, Brazil, Paraguay and Uruguay, levies no tariffs on wheat imported from Argentina, while wheat from other origins, including the United States, are subject to a 10-percent ad valorem tariff. The decline in world wheat prices in late 1996 and early 1997 resulted partly from the aggressive marketing of the record Argentine crop.

Argentina's wheat prospects continue to be closely tied to world developments, particularly since the government opened up the economy in the early 1990s. USDA's projections for lower wheat prices through the year 2000 relative to the unusually high levels of 1995/96 and 1996/97 should produce corresponding downward adjustments in Argentina's wheat area. However, for the remainder of the decade, harvested wheat area is projected to remain above the average of 5.6 million hectares during the 1980s and 4.9 million in the early 1990s. A more neutral agricultural policy, compared to an anti-farm policy of export taxes that existed until 1991, will help sustain Argentine wheat area, as will world wheat prices that are anticipated to remain sufficiently attractive from a producer standpoint.

The increased adoption of technology should raise Argentine yields and contribute to rising production prospects, including possible records in years of favorable weather. However, because the USDA baseline assumes normal weather, wheat output and exports for 2000/01 are projected at 13.9 and 9.4 million tons, respectively, up from 10.1 and 5.6 million tons averaged in the early 1990s. Most of the changes in wheat area come from land competing and rotating with cattle, for which profitability and productivity gains have lagged relative to crops. Most other major grains and oilseeds are expected to see increases in area for similar reasons. Cattle are projected to occupy smaller areas, although on much of the less-than-prime cropland they will still be extensively used in rotation with wheat and other crops. Nevertheless, given the projected price scenario, the introduction of new land for wheat in Argentina is unlikely, given the high costs involved to bring such lands into productive use.

### *Can Canada Soon Repeat Its Large 1996 Crop?*

Extremely low carryin stocks and high wheat prices in early 1996 encouraged significantly larger plantings of wheat in Canada at the expense of alternative crops such as canola (rapeseed) and flaxseed. More than 12.9 million hectares were devoted to wheat in 1996, in contrast to an average of 11.5 million in the previous 3 years. Area planted to durum wheat (2.1 million), and non-durum wheat (10.8 million), exceeded the averages of the past 3 years.

Although spring planting was delayed due to wet weather, and despite an outbreak of yield- and quality-reducing Fusarium Head Blight in eastern Canada, generally favorable weather throughout the growing season led to record yields. As a result, Canada's 1996 wheat production was the largest since 1991.

The particular circumstances that contributed to the large 1996 crop are unlikely to repeat themselves, however, and Canadian wheat production prospects for the rest of the decade are closer to 1995's 25.4 million tons than 1996's 30.5 million. Production of other crops, particularly new varieties of canola, are becoming increasingly competitive with wheat. During 1994 and 1995, canola acreage rose to 5.75 and 5.3 million hectares, respectively, after ranging between 2.5 and 3.7 million hectares during 1984-92. In 1996, higher wheat and barley prices relative to canola strongly encouraged plantings of these grains at the expense of canola. After 1996, however, lower projected prices for wheat and barley will help restore canola production to near 1994 and 1995 levels.

A second factor that will favor alternative crops such as canola and barley over wheat is the removal of the Western Grain Transportation Act (WGTA) on August 1, 1995. The WGTA subsidized the transportation of grains and oilseeds in western Canada for export. Under the WGTA, Canada's railways were permitted to charge shippers approximately CAN$19 per ton to move grain from a midpoint of Prairie Provinces to an export position, while the government paid the railroads an additional CAN$12 to CAN$19 per ton. A freight rate cap, adjusted for inflation, was established on August 1, 1995 to

last until July 31, 2000 to protect farmers shipping grain from large rate increases. The current range of maximum freight rates for wheat in the 1996/97 marketing year are estimated between CAN$35 and CAN$48, varying by delivery point and date of delivery. The WGTA encouraged production and export of lower-valued grains and oilseeds from the Prairie Provinces at the expense of processed products. Its elimination encourages reallocation of resources to other farm output such as livestock and value-added products and to crops, such as malting barley and canola that support these activities, as opposed to export-oriented wheat. Feed barley and canola are more likely to be sold and consumed in the Prairie Provinces as processing industries and livestock production expand.

Beginning in 1997, moderating grain prices are expected to lead to a shift from wheat toward alternative crops, such as canola. After 1997, alternative grains such as malting barley and oats will compete strongly for acreage as well. All of these crops have unique characteristics that are likely to guarantee certain export markets for the future. Canadian canola is preferred by Japanese importers. Canadian oats are indispensable to U.S. oats processors. Canadian and Australian malting barley are positioned to benefit from increasing demand from importers in China and Latin America. For these reasons, wheat area is expected to decline in 1997 and remain near the 1993-95 level of 12 million hectares through 2000. Production is projected to expand slowly to slightly more than 26.5 million metric tons as yields gradually increase. Through 2000, Canada's wheat exports are limited to slightly over 18 million tons.

### *Australia's Wheat Production Highest on Record*

Australia's 1996/97 wheat crop, harvested in October-December 1996, is forecast to be a record large 23 million tons. World wheat prices were high when planting began in April 1996. Harvested area rose 14 percent from 1995/96 to 11.1 million hectares, far greater than the previous 9-year average of 8.7 hectares. Area was shifted out of sorghum and pasture (largely for sheep grazing) as well as other uses to take advantage of the relatively more attractive returns for wheat. In addition, favorable weather boosted yields in Australia to the highest level on record, according to the USDA database.

Australia's October/September marketing year wheat exports are forecast to rise 36 percent from 1995/96 to 16.5 million tons in 1996/97. Australia is attempting to export as much as possible before 1997 new-crop supplies come on the market from the Northern Hemisphere countries, but the huge crop means Australia will have to continue to export large supplies in the summer and fall of 1997. Despite the push, Australia's end-of-year wheat stocks are forecast to increase dramatically. Australia began 1996/97 with low stocks because of the devastating drought in 1994/95 when production fell to 8.9 million tons, about half the previous year's output.

Because world wheat prices have declined significantly since spring 1996, when Australia's 1996/97 crop was planted, wheat growers will likely receive lower returns than they expected at that time. Lower world prices are expected to continue into 1997 and as a result, Australia's wheat planting for 1997/98 is anticipated to be reduced. However, if prospects continue to be relatively favorable in the next two to three months of 1997, wheat area will remain strong relative to recent years, other than 1996/97.

As world grain trade is liberalized under the provisions of the GATT Uruguay Round Agreement on Agriculture and as global economic and population growth continues, Australia's wheat exports are projected to continue to average nearly 15 million tons in the 1998/99-2000/01 period. Wheat area is projected to continue to grow modestly to 2000 and yields are likely to rise also. Constraining growth is the relatively higher returns to wool projected during the next few years. There has been some adoption of higher yielding wheat varieties better suited for feed for Australia's expanding dairy cattle operations, but feed demand from the beef industry is not expected to increase much. Although output and exports of beef are projected to increase, poor returns and large competing supplies of meat, mainly from the United States, will slow herd rebuilding.

### *EU Export Tax Removed with Bountiful 1996 Wheat Harvest*

The European Union (EU) in 1992 revamped its Common Agricultural Policy (CAP) for grains in order to reduce burdensome grain stocks, increase domestic grain consumption (primarily as feed) and lower budgetary outlays. Under CAP reform, internal grain prices were lowered and a mandatory land set-aside was implemented. To compensate farmers for lost income from lower prices, direct payments were provided.

Since the first year of CAP in the 1993/94 crop year, the objectives of increasing internal grain consumption and stock reduction have been achieved with great success. However, the decline in wheat stocks became so serious during 1995/96 that the EU imposed a $32-per-ton export tax on soft wheat exported outside the EU in December 1995, in order to keep internal wheat prices from rising along with world prices. This was the first time the EU taxed grain exports since 1974. With domestic consumption on the rise, the EU wanted to prevent any decreases in domestic supply that would further drive up EU grain prices and limit feed use. As world prices increased, the export tax increased as well, reaching a high of $58-per-ton in late April 1996. The export tax kept wheat on the domestic market, causing the EU's 1995/96 wheat exports to fall a third from the previous year.

The sharp rise in world wheat prices during 1995 and early 1996, a decrease in the rotational EU set-aside for grains under CAP Reform to 10 percent for 1996/97, and much improved weather in Spain raised EU wheat production more than 13 million tons from 1995/96. Larger wheat supplies in the EU and in other countries have caused world wheat prices to decline since spring 1996 and the EU correspondingly decreased its export tax. The export tax was completely eliminated this past September, when the world price of wheat fell below the internal EU price, and the EU began subsidizing its wheat exports once again. EU exports in 1996/97 are projected to increase 16 percent from 1995/96 but remain significantly below the levels of the early 1990s.

EU policy changes implemented under CAP Reform and the GATT Uruguay Round Agreement commitments on reductions in subsidized exports mean that the EU can be expected to play a less prominent role in world wheat trade through

2000, relative to the late 1980s and early 1990s. The 5-percent set-aside rate in place for 1997/98 will result in ample wheat production but EU wheat consumption is also expected to increase, due to stronger demand for wheat in feeding. Feed demand for grains has been increasing in recent years due to internal price reductions resulting from the 1992 CAP reform. The EU Commission's concerted effort to keep grain prices low enough to make grain an attractive feed, thereby keeping the EU within its subsidized export limits without building large stocks, has also spurred feed demand. Further increases in feed use are expected because the bovine spongiform encephalopathy (BSE) scare has led to an increase in demand for pork and poultry, which consume much more grain than cattle. For the remainder of the decade, USDA projects the set-aside rate to be set at 12 percent. Each year, lower GATT export bounds will increasingly constrain the EU's wheat output, but strong domestic demand will keep the exportable surplus from depressing price much below the intervention price. The world market price for wheat is not projected to equal or exceed the EU market price again until 2001, preventing the EU from exporting marginal amounts of wheat without subsidy until then.